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Message Text

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ACTION NEA-10

INFO OCT-01 ISO-00 ERDA-05 AID-05 CEA-01 CIAE-00
COME-00 EPG-02 DODE-00 EB-07 FEAE-00 FPC-01 H-01
INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-04
USIA-06 OES-07 SP-02 SS-15 STR-04 TRSE-00 ACDA-07
PA-01 PRS-01 /101 W
----------261257Z 054018 /45
R 261122Z MAY 77
FM AMEMBASSY TEHRAN
TO SECSTATE WASHDC 2809

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E.O.11652: N/A
TAGS: ENRG, IR
SUBJ: RECENT DEVELOPMENTS AFFECTING IRANIAN OIL PRODUCING
JOINT VENTURES

REF: 76 TEHRAN A-196

SUMMARY: EARLIER THIS MONTH, NIOC CONCLUDED NEGOTIATIONS WITH THE LAST OF IRAN'S FOUR OFF-SHORE PRODUCING JOINT VENTURES OVER ADOPTION OF HIGHER ROYALTY AND TAX RATES. ALTHOUGH THE LAST THREE AGREEMENTS TO BE REVISED ARE STILL AWAITING APPROVAL OF THE FINANCE MINISTRY, THE SECOND PARTIES OF ALL THE JOINT VENTURES HAVE AGREED TO PAY ROYALTY OF 20 PERCENT (16.67 PERCENT PREVIOUSLY) AND TAX OF 85 PERCENT (65.75 PERCENT PREVIOUSLY). MOREOVER, THE NEW RATES ARE TO BE APPLIED RETROACTIVELY TO NOVEMBER 1974. ALMOST CONCURRENTLY WITH THE CONCLUSION OF NEGOTIATIONS ON THE JOINT VENTURE AGREEMENTS, NIOC PROPOSED THE ESTABLISHMENT OF A JOINT OPERATING COMPANY FOR ALL FOUR JOINT VENTURES AND SOFIRAN -- AN NIOC SERVICE CONTRACTOR THAT WILL SOON BE PRODUCING OIL. IN THEORY, THE IDEA OF A SINGLE OPERATING COMPANY IS APPEALING BUT THE CREATION AND OPERATION OF SUCH A COMPANY WILL POSE MANY DIFFICULT, IF NOT IRRESOLVABLE, PROBLEMS AND CONFLICTS.
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1. REFERENCED AIRGRAM REPORTED ON NEGOTIATIONS THEN UNDERWAY WITH THREE OF IRAN'S FOUR PRODUCING JOINT VENTURES IN WHICH NIOC OWNS 50 PERCENT SHARE -- IPAC (50 PERCENT AMOCO); LAPCO (12-1/2 PERCENT EACH, ARCO, MURPHY OIL, SUN OIL AND UNION OIL); AND IMINOCO (16-2/3 PERCENT EACH, PHILLIPS PETROLEUM, AGIP, AND OIL AND NATURAL GAS COMMISSION OF INDIA). NEGOTIATIONS

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WERE COMPLETED THIS MONTH WITH THE LAST OF THESE JOINT VENTURES
AND NEW AGREEMENTS HAVE BEEN INITIALED WITH LAPCO AND IMINOCO
WHILE NIOC AND AMOCO HAVE SIGNED A PROVISIONAL AGREEMENT GOVERNING
RELATIONSHIPS IN IPAC. THE NEW IPAC AGREEMENT WILL BECOME EFFEC-
TIVE WHEN MINISTERIAL (READ MINISTRY OF FINANCE AND ECONOMIC
AFFAIRS) APPROVAL HAS BEEN OBTAINED. SIMILARLY, FORMAL SIGNING
OF THE LAPCO AND IMINOCO AGREEMENTS IS EXPECTED WHEN THE FINANCE
MINISTRY APPROVES THE NEW TERMS.

2. THE BASIC TERMS AGREED UPON ARE SUBSTANTIALLY AS PREDICTED
IN REFERENCED MESSAGE. AS REPORTED, THE SECOND PARTIES IN THE
THREE JOINT VENTURES HAVE AGREED TO (1) ROYALTY RATE OF 20 PERCENT
OF POSTED PRICE (2) TAX OF 85 PERCENT ON A TAX BASE CALCULATED
BY DISCOUNTING POSTED PRICE BY 7 PERCENT AND SUBTRACTING ROYALTY
PAYMENTS AND PRODUCING COSTS, AND (3) THE RETROACTIVE APPLICATION
OF THE NEW, HIGHER ROYALTY AND TAX RATES TO NOVEMBER 1974. THE
RETROACTIVE PAYMENT IS TO BE PAID OVER FIVE YEARS.

3. WHILE NEOGTIATIONS OVER FINANCIAL TERMS WERE PROCEEDING WITH
THE FOREIGN PARTNERS IN THE THREE JOINT VENTURES THAT HAD NOT
YET ACCEPTED THE 20/85 PERCENT RATES, NIOC WAS PREPARING A PRO-
POSAL TO DRASTICALLY ALTER THE ORGANIZATIONAL STRUCTURE AND
FUNCTIONS OF ALL FOUR JOINT VENTURES AND THE ONE NIOC SERVICE
CONTRACTOR THAT IS ABOUT TO BEGIN PRODUCING OIL. ON MAY 14--
WITHIN A WEEK OF THE CONCLUSION OF NEGOTIATIONS ON THE LAST
OF THE JOINT VENTURE AGREEMENTS--IDENTICAL LETTERS WERE SENT
BY NIOC TO SIRIP, LAPCO, IPAC, IMINOCO, AND SOFIRAN (A NIOC
CONTRACTOR OWNED BY ERAP, MITSUBISHI AND AQUITAINE WHICH WAS
EXPECTED TO BEGIN PRODUCING FROM THE OFF-SHORE SIRRI FIELD
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THIS YEAR UNDER TERMS OF ITS 1966 AGREEMENT). IN THIS LETTER,
NIOC SAID THAT IT HAD BEEN DECIDED TO ESTABLISH A JOINT
OPERATING COMPANY TO HANDLE THE DEVELOPMENT, PRODUCTION AND
EXPORTING FUNCTIONS OF THE JOINT VENTURES AND SOFIRAN, AND
THAT THE PERSONNEL AND OPERATIONS OF THIS NEW ENTITY WOULD
BE BASED IN SHIRAZ. THE LETTER ADDED THAT THE RIGHTS OF
THE SECOND PARTIES SUCH AS CRUDE OIL LIFTINGS, PLANNING AND
BUDGETING AND PROPER AND SEPARATE ACCOUNTING WOULD BE MAIN-
TAINED AND PROTECTED. NIOC INVITED SECOND PARTY REPRESENTA-
TIONS TO BEGIN NEGOTIATIONS/PLANNING THE WEEK OF MAY 23.
(IN FACT, PRELIMINARY MEETINGS ARE SCHEDULED TO BEGIN WITH
NIOC ON MAY 29.)

4. IN ITS LETTER, NIOC SAID THAT ITS PROPOSAL
WAS MADE IN RESPONSE TO THE DIRECTIVES OF A ROYAL DECREE ON
ECONOMY AND EFFICIENCY AND BECAUSE OF THE GOVERNMENT'S DESIRE
TO LOCATE AND CONDUCT INDUSTRIAL AND ECONOMIC ACTIVITIES WHEN-
EVER POSSIBLE OUTSIDE OF TEHRAN. THE ROYAL DECREE MENTIONED
BY NIOC WAS ISSUED LAST NOVEMBER AND RESULTED IN THE CREATION

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OF AN IMPERIAL COMMISSION ON EFFICIENT RESOURCE APPLICATION. THE COMMISSION, IN TURN, ESTABLISHED EIGHT SPECIALIZED COMMITTEES, INCLUDING ONE ON ENERGY MATTERS. WITHIN THE LAST WEEK, THE SHAH HAS ATTEMPTED TO GIVE A NEW IMPETUS TO THE COMMISSION AND ITS ACTIVITIES, AND THERE HAS BEEN A MILD

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INFO OCT-01 ISO-00 ERDA-05 AID-05 CEA-01 CIAE-00
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INR-07 INT-05 L-03 NSAE-00 NSC-05 OMB-01 PM-04
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FLURRY OF PUBLICITY AND AN ATTEMPTED SHOW OF PROGRESS. APPARENTLY, THE INITIATIVE CONCERNING THE CREATION OF A JOINT OPERATING COMPANY IS, IN PART, AREFLECTION OF NIOC'S NEED TO RESPOND TO ONE OF THE SHAH'S CURRENT CAUSES. NIOC IS, AFTER ALL, A LARGE AND HIGHLY VISIBLE GOVERNMENT ORGANIZATION. MOREOVER, ACCORDING TO WELL-INFORMED EMBASSY SOURCES, THE IDEA OF A JOINT OPERATING COMPANY IS THE BRAINCHILD OF ONE OF THE MOST INFLUENTIAL NIOC BOARD MEMBERS WHO BELIEVES THAT HS PROPOSAL IS FEASIBLE AND WILL RESULT IN SUBSTANTIAL SAVINGS.

5. DESPITE THE SUPERFICIAL ATTRACTIVENESS OF COMBINING THE OPERATIONS OF FIVE RELATIVELY SMALL PRODUCERS, SERIOUS PROBLEMS ARE ANTICIPATED. GIVEN THE DIVERSE INTERESTS, COMPANY PHILOSOPHIES, LEVELS OF INVESTMENT, ETC. OF THE VARIOUS COMPANIES INVOLVED, IT IS UNLIKELY THAT ANY OF THE SECOND PARTIES INVOLVED WILL WILLINGLY CONCEDE ANY OF THEIR EXISTING AUTHORITY TO A NEW JOINT OPERATING COMPANY. IF, ON THE OTHER HAND, AN ORGANIZATIONAL STRUCTURE COULD BE CREATED WHICH WOULD RESPOND TO THE INDIVIDUAL NEEDS AND DESIRES OF THE VAROUS JOINT VENTURES AND SOFIRAN, IT IS VERY DOUBTFUL THAT THE ENTITY WOULD BE EITHER EFFICIENT OR

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ECONOMICAL. EMBASSY SOURCES ALSO HAVE GRAVE RESERVATIONS ABOUT THE EFFICACY OF SHIFTING OPERATIONS TO SHIRAZ. THERE ARE INDICATIONS THAT A SUBSTANTIAL NUMBER OF THE IRANIAN SENIOR STAFF OF IPAC, LAPCO, ET A WOULD OBTAIN A TRANSFER TO NIOC OFFICES IN TEHRAN OR RESIGN IN PREFERENCE TO MOVING. THE RESULT COULD EVEN BE AN ABSOLUTE AND RELATIVE INCREASE IN THE NUMBERS OF EXPATRIATES IN THE INDUSTRY--ESPECIALLY AT MANAGEMENT LEVELS.

6. IT IS NOT YET CLEAR HOW HARD NIOC IS GOING TO PUSH FOR THE ESTABLISHMENT OF A JOINT OPERATING COMPANY BUT IT IS CLEAR THAT THERE WILL BE STRONG RESISTANCE; AND, NEGOTIATIONS, EVEN IF SUCCESSFUL, CAN BE EXPECTED TO DRAG ON FOR A LONG WHILE.

7. THERE ARE MANY POSSIBLE SCENARIOS, INCLUDING THE EVENTUAL NATIONALIZATION OF THE FOREIGN INTERESTS INVOLVED AND THE SUBSEQUENT CONSOLIDATION INTO A SINGLE COMPANY IN WHICH FOREIGN OIL FIRM'S) MIGHT BE INVITED TO INVEST AND PROVIDE TECHNICAL AND MANAGERIAL SUPPORT. NIOC MIGHT ALSO BE BE CONVINCED THAT ITS IDEA IS NOT PRACTICAL AND DROP IT. HOWEVER, GIVEN IRANIAN SENSITIVITIES AND THE RELATIVE WEAKNESS OF NIOC'S FOREIGN PARTNERS IN ANY CONFRONTATIONAL SITUATION, SOME SORT OF COMPROMISE SEEMS MORE LIKELY. ONE SUCH POSSIBILITY IS FOR LAPCO TO UNDERTAKE, ON A CONTRACTUAL BASIS, THE OPERATIONAL ACTIVITIES OF IMINOCO AND SOFIRNA; WHILE, IPAC TAKES ON THE SAME FUNCTION FOR SIRIP. SUCH A COMPROMISE COULD BE ATTRACTIVE SINCE OFF-SHORE OIL PRODUC-TION IS CENTRALIZED IN, OR NEAR, TWO LOCATIONS: LAVAN ISLAND FOR LAPCO, IMINOCO AND SOFIRAN; AND KHARG ISLAND FOR IPAC AND SIRIP. MOREOVER, OF THE FIVE ENTITIES INVOLVED, IPAC AND LAPCO ARE BY FAR THE LARGEST IN TERMS OF CURRENT AND POTENTIAL PRODUCTION AS WELL AS PERSONNEL STRENGTH.

8. EMBASSY WILL CONTINUE TO FOLLOW DEVELOPMENTS CLOSELY
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AND REPORT AS APPROPRIATE.
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Disposition Approved on Date:
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